NATIONAL FORECAST DESCRIPTION

The Forecast Period is the Third Quarter of 2006 through the Fourth Quarter of 2010

If the U.S. economy were graded on its recent performance, its report card would state that while it may not be failing, it could be doing better. The economy shifted into lower gear in the second half of last year, with real GDP advancing at a meager 2.6% annual rate in the second quarter followed by 2.0% in the third quarter and an estimated 1.2% rate in the last quarter. Real output should begin to accelerate this year, but at less than 3.0% growth it will remain well below its potential. The cooling housing market is partially to blame for this sub-par performance. The U.S. Department of Commerce reported real residential fixed investment tumbled 11.1% in the second quarter of 2006 and fell 18.7% in the third quarter. While some housing indicators suggest the industry is stabilizing, it will take a while to steady this ship. In fact, activity will continue to fall as builders attempt to get control of large unsold inventories. As a result, housing starts are expected to decline another 16.9% this year.

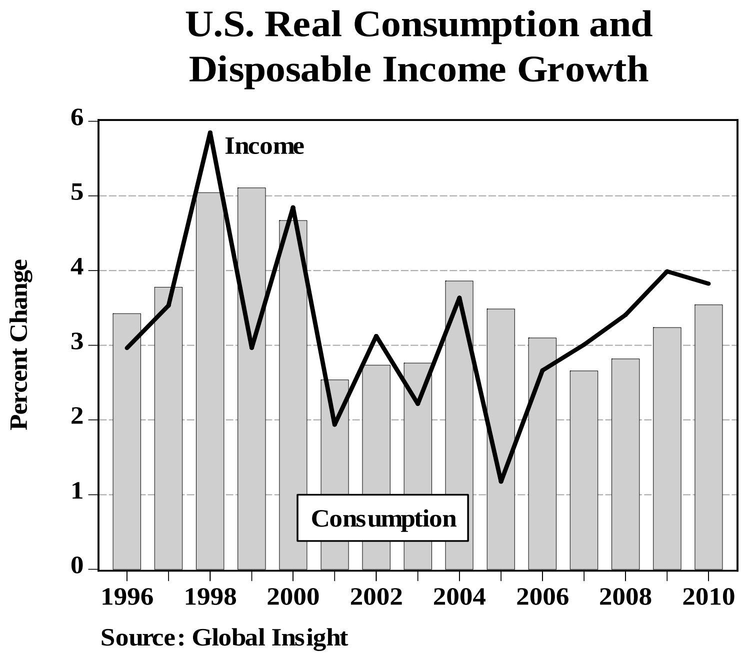
The impacts of the housing decline will be partially deflected by other economic factors. For example, while residential construction has suffered, nonresidential construction has thrived because of post-hurricane rebuilding, rising utilization rates, and falling office vacancy rates. Nonresidential construction will soften the blow from falling housing starts this year, but it will only provide temporary relief. Eventually, it will weaken under the weight of the ebbing housing sector. Falling oil prices should also help. The roughly 80-cent per gallon decline in gasoline prices since the summer of 2006 has operated like a tax cut for households worth $96 billion, or 1.0% of disposable income. So far, households have been hesitant to spend this found money, probably because they fear gasoline prices will shoot up again. However, once they are convinced this will not happen, they will spend more freely.

Higher capacity utilization rates and the need to remain competitive are spurring business fixed investment. Orders for nondefense capital goods excluding aircraft are outstripping shipments, signaling rising order backlogs and solid business spending growth ahead. Another positive factor is trade. Improving economic growth abroad and the declining dollar point to strong exports. The dollar’s value has dipped because the U.S. economy has weakened relative to other major economies. The greenback will come under pressure as foreign central banks raise interest rates. Thus, it is anticipated by the end of 2007 the euro will rise above $1.40 and the yen will reach 105 per dollar.

Inflation has probably topped out, but it is still too high for the Federal Reserve’s comfort. While falling gasoline prices helped keep consumer inflation below 2.0% this fall, core inflation (all items less food and energy) remain well above the central bank’s 1-2% comfort zone. Cooler growth and slower housing costs increases should help core inflation drop below 2.0%. However, not even this will keep the Federal Reserve from worrying. It remains nervous about labor costs, since labor markets remain tight and productivity growth has slowed. However, the Federal Reserve is expected to lower interest rates three times in 2007, so its federal funds rate is 4.5% by the end of this year.

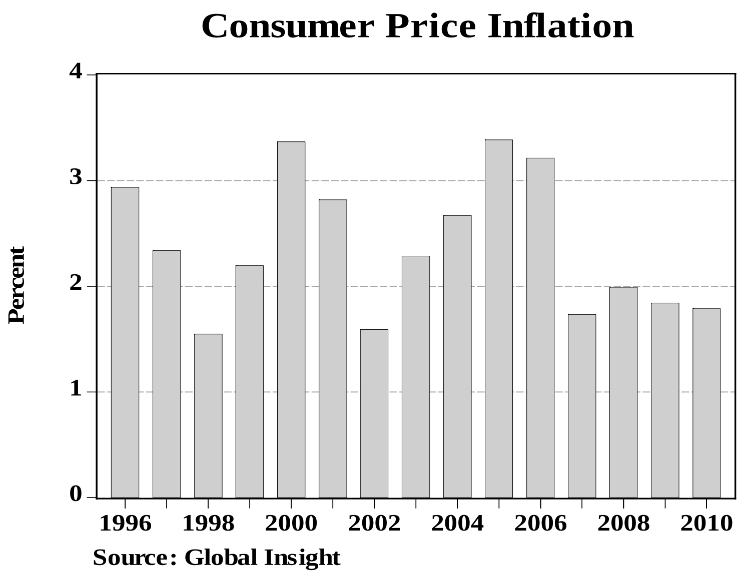
After this year, the economy is expected to move up to its potential. Real GDP should advance by at least 3.0% in each year after 2007. The housing inventory should be manageable, and housing starts should start to recover slowly. Nonfarm employment growth is expected to march to a 1.4% average annual cadence. At this pace, the civilian unemployment rate will eventually fall to 4.4% by 2010, which is comfortably full employment.

SELECTED NATIONAL ECONOMIC INDICATORS



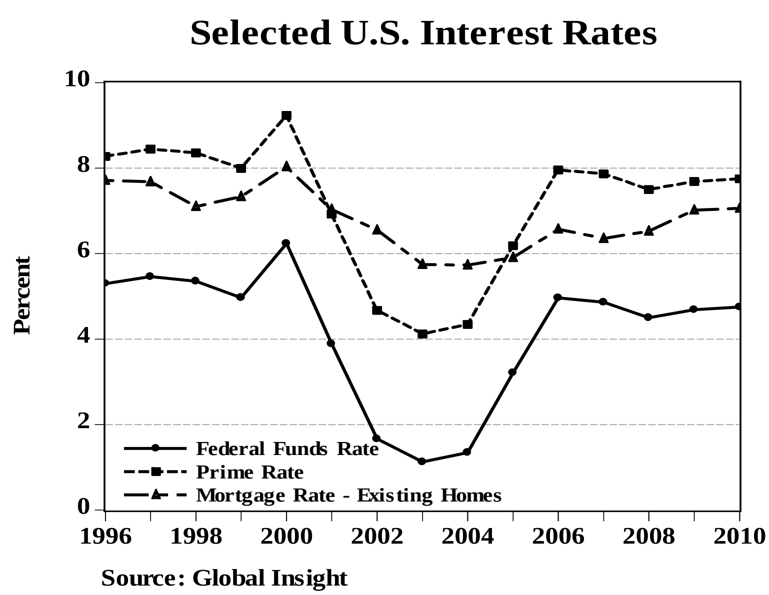
Consumer Spending: The negative impact of the cooling housing market on consumer spending will be mitigated by steady job growth, rising wages, and lower gasoline prices. Although the U.S civilian unemployment rate did inch up 0.1 percentage point from October 2006 to 4.5% in November, this rate is near its lowest level in five years and well below the 5.0% threshold considered to be full-employment. Other evidence of the labor market's strength is September's 203,000-increase in nonfarm jobs. These strong employment gains have tightened labor markets, which have fueled moderate wage gains that are outpacing inflation for the first time since 2003. Interestingly, these gains have not been as strong as initial estimates. For example, during last year's third quarter employment unit labor costs expanded 2.3%, which is significantly lower than the original estimate of 3.8% growth. Falling gasoline prices will feel like a tax break to American consumers and contribute to the first inflation decline in a generation. These three factors are major contributors to the expected turnaround in real disposable income. After expanding a meager 1.2% in 2005, real disposable income is forecast to accelerate during most of the forecast period, growing 2.7% in 2006, 3.0% in 2007, 3.4% in 2008, 4.0% in 2009, and 3.4% in 2010. While consumers' income statements are improving, household balance statements are not likely to maintain the momentum experienced over the past few years. Specifically, thanks in large part to strong home price appreciation, U.S. household real net worth increased 4.7% in 2005. This rate will be the high-water mark for the foreseeable future as housing prices grow more slowly during the next few years. As a result, real net worth is forecast to rise 1.5% in 2006, 0.6% in 2007, 2.9% in 2008, 3.2% in 2009, and 4.5% in 2010. The impact of lower housing price appreciation will affect more than real net worth, however. It will also dampen real consumer spending because it will lead to cutbacks in spending on furniture, appliances, and other durable goods. In addition, consumer spending will be limited by disappearing financing sources. Home equity withdrawals, a funding source for home improvements and consumer spending, are likely to drop off in 2007. In addition, consumers are likely to proceed with caution after watching housing prices stall, or fall in some markets. One beneficiary of consumers' caution is the personal savings rate. After being negative since early 2005, it will eventually turn positive in late 2008. Real consumer spending is forecast to rise 3.1% in 2006, 2.7% in 2007, 2.8% in 2008, 3.2% in 2009, and 3.5% in 2010.

Inflation: Rising labor costs moved to the forefront of inflation watchers radar screens, as oil prices fell from last summer's peak. One noted analyst is Federal Reserve Chairman Ben Bernanke who observed labor costs "have been rising more quickly of late" and "part of this acceleration no doubt is current tightness in labor markets." His attention was well placed given labor costs' major role in driving core inflation (all items less food and energy). His conclusions, however, were based on data that overstated labor costs. For example, the third-quarter rise in unit labor costs was revised down from a 3.8% annual rate to a more moderate 2.3% rate. Furthermore, second-quarter unit labor costs, which were originally reported to have surged 5.3%, actually declined 2.4%. Year-over-year, third-quarter unit labor costs increased just 2.9%, which is significantly lower than the previous estimate of 5.3%. Looking ahead, it



appears unit labor costs will grow more slowly than in 2006 over the forecast period. Specifically, unit labor costs are expected to increase 4.1% in 2006, 3.2% in 2007, 2.7% in 2008, 3.0% in 2009, and 3.2% in 2010. This outlook is based on the cooling economy and its attendant labor market pause and recovering labor productivity. Although labor prices have moved into focus, energy prices also remain in view. This should not come as a surprise given the multi-year run up in oil prices that peaked at over $70 per barrel last summer. The good news is that oil prices should retreat from last year's apex and stabilize over the forecast period. However, oil prices will stabilize near the top end. Crude oil prices are forecast to average $64.44 per barrel in 2007, $64.77 per barrel in 2008, $63.88 per barrel in 2009, and $63.40 per barrel in 2010. To put these prices in perspective, the price of oil averaged about $20 per barrel during the 1990s and was about $26 per barrel at the beginning of the current decade. Nonetheless, as a result of the better-behaved oil prices, the energy component of the consumer price index is expected to fall 2.9% this year, rise a modest 1.9% next year, and remain flat over the remaining forecast years. Overall inflation, as measured by the consumer price index, is anticipated to be 1.7% in 2007, 2.0% in 2008, and 1.8% in both 2009 and 2010.

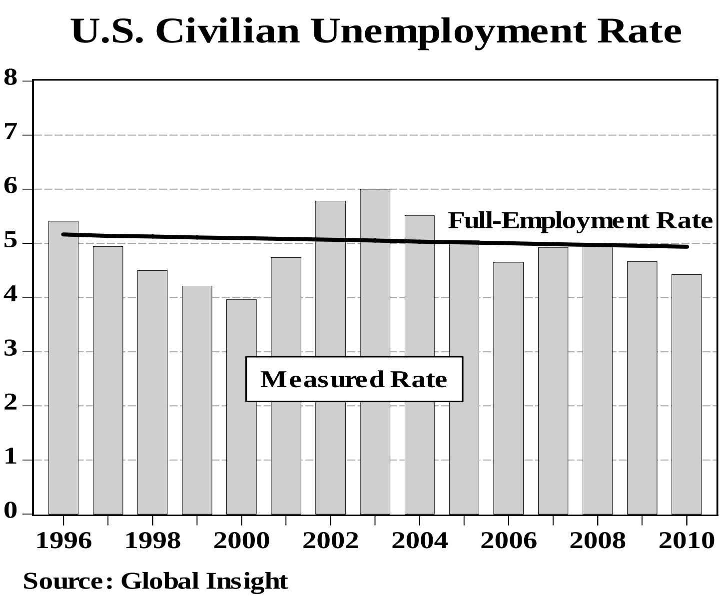
Financial Markets: These days what the Federal Reserve says is having as big an impact as what it does. Indeed, the nation's central bank appears to be in wait-and-see mode. The Federal Reserve voted on December 12, 2006 to keep its federal funds rate at 5.25% for the fourth consecutive meeting. This action came as no surprise to Federal Reserve watchers because the decision to hold rates steady is consistent with its policy that began last summer. This policy is shaped by concerns of heating inflation and the cooling economy. Interestingly, the most anticipated part of the December meeting was not the federal interest rate target, but the brief statement released after the meeting. It reported the Federal Reserve continued to have concerns about inflation and the economy. It edged down its assessment of economic conditions compared with its October 25, 2006 statement. It now describes the cooling of the housing market as "substantial" and "recent indicators have been mixed." In light of these expressed concerns this forecast assumes the nation's central bank will hold the federal funds rate steady through early May 2007. After that time, it will begin to gradually decrease this bellwether interest rate. Specifically, the federal funds rate will decline in 25-basis point increments on May 9, 2007, followed by cuts on June 28 and August 7. As a result of these cuts, the federal funds rate will settle at 4.5% in the last quarter of 2007 and



remain at that level through the first quarter of 2009. The federal funds rate is assumed to rise slightly thereafter, averaging just under 5.0%. The future course of the federal funds rate and other closely-watched interest rates are illustrated in the accompanying chart.

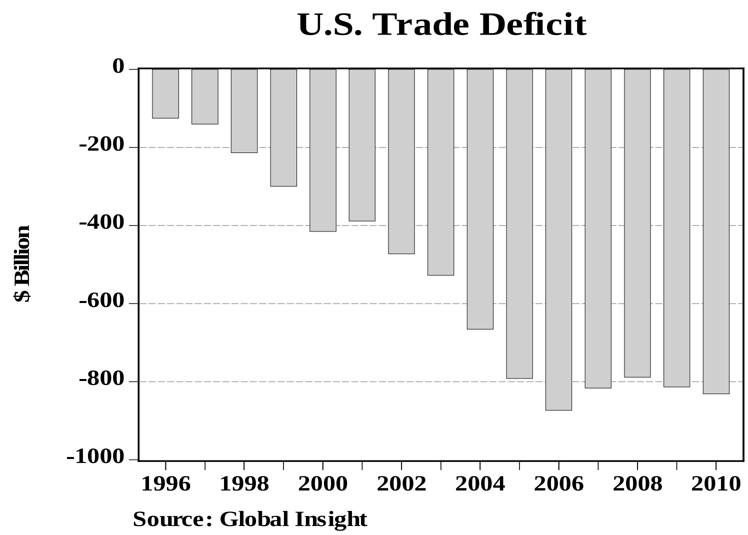
Government: The federal budget deficit declined from $321 billion in federal fiscal year 2005 to $248 billion in federal fiscal year 2006. The 2006 deficit was lowered in the final month of the year by a surge in revenues and some timing issues that pushed Medicare expenditures into fiscal year 2007. On an annual basis, federal receipts increased 11.8% in fiscal year 2006, while outlays rose 7.8%. After hitting its lowest point this decade, the federal budget deficit is expected to inch upwards through 2008 then fall gradually through 2010. Congress passed two measures with budget implications: the extension of the continuing resolution on discretionary spending and the Tax Relief and Health Care Act of 2006. The continuing resolution will have a dampening effect on fiscal 2007 spending. The tax relief legislation includes extensions of tax credits and deductions that either expired at the end of 2005 or would expire at the end of 2008. The provisions of this bill include the deduction for higher education expenses, the deduction of state and local sales taxes, a corporate research credit, a credit for alternative energy production, a credit for residential energy efficient property, and provisions for energy efficient buildings and new homes. The incoming Congress will have a new set of policy matters to consider. There are two major policy issues that are likely to receive attention before the next administration moves into the White House. Raising the federal minimum wage is a major economic policy initiative that is expected to move quickly through the Democratic Congress and is likely to be assented to by President Bush. Although the 41% increase from $5.15 per hour to $7.25 per hour is large, its ripple effect through the economy is likely to be smaller. First, the anticipated hike to $7.25 per hour will cause the federal minimum wage to catch up with the existing minimum wage rates of about half the states. Second, due to tight labor markets, entry-level wage rates in many local areas are already above the proposed national minimum wage. Third, the Federal Reserve has given its nod for an increase, so it appears it will not unduly react to temporary upward blips in the employment cost index that would follow. Another pressing issue is the alternative minimum tax (AMT). The AMT will start biting middle-class taxpayers much harder, unless increased exemptions are extended beyond the end of 2006. This forecast assumes no permanent action will be taken on the AMT until after the 2008 election. Instead, the exemptions will be extended yearly until a permanent fix is enacted.

Employment: National nonfarm employment growth is expected to moderate in the short-term from its recent pace. It is estimated 1.9 million jobs were added in 2006, or about 157,000 jobs per month. The civilian unemployment rate fell to 4.6% from the previous year's 5.1% rate. What these annual statistics do not show is the labor market was already showing signs of slowing in late 2006. For example, during the second half of last year the monthly job pace had dropped to about 134,000 jobs per month, versus over 161,000 jobs per month during the first half of 2006. This trend is expected to continue early into this year. As a result, the U.S. civilian unemployment rate is expected to inch up above 5.0% in 2007. While the employment situation is softer in 2007 compared to 2006, it is not as bad as it may appear on the surface. First, the weaker employment situation is temporary. After falling below a one-percent annual pace during the first half of this year, nonfarm employment

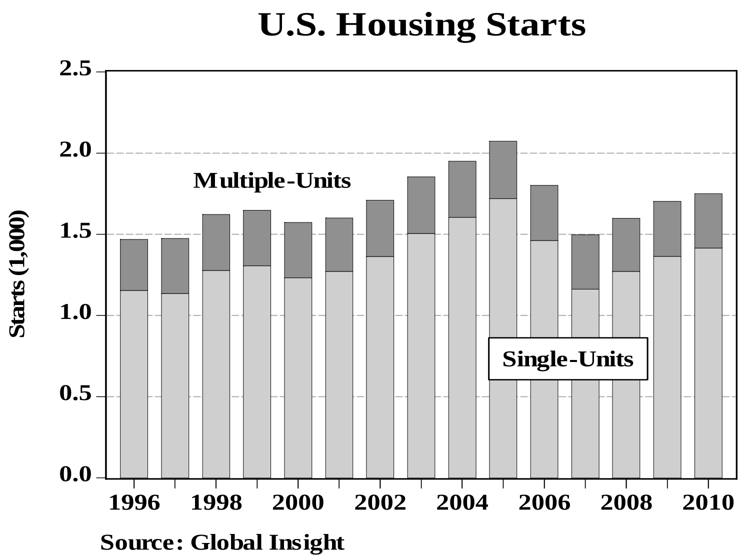


should begin logging healthier gains during the second half of 2007. The fallout from this slower employment growth will hang on through the first half of 2008. However, even at its apex the unemployment rate is barely above the full-employment threshold. National nonfarm employment is forecast to expand 1.4% in 2006, 0.9% in 2007, 1.3% in 2008, 1.5% in 2009, and 1.4% in 2010. The forecasted civilian unemployment rate is 4.6% in 2006, 4.9% in 2007, 5.0% in 2008, 4.7% in 2009, and 4.4% in 2010. The minimum wage rises in three steps to $7.25 per hour in this forecast. While the minimum wage debate has focused on demand, it could also increase supply. Teenage labor-force participation has slumped to 43.5%, from 52% in 2000. Since about a quarter of minimum wage earners in 2005 were teenagers, any labor-supply impact would show up in this category. It is estimated each percentage point increase in the teenage participation rate changes the unemployment rate 0.1 percentage point. For example, should the teenage participation rate recover half the ground lost since 2000 by rising 4.25 percentage points, the employment rate would increase almost 50 basis points.

International: The improving trade picture will be a major plus to the economy over the forecast period. It is estimated real net exports (exports less imports) will contribute 0.8 percentage point to output growth during the fourth quarter of 2006—its strongest positive contribution in 10 years. On an annual basis, net exports in 2006 will be slightly higher than in 2005. However, these annual statistics mask last year's improvements. Keep in mind the real trade gap narrowed by close to $30 billion from the first quarter of 2006 to the last quarter. Gains should continue through 2010, with the fastest improvement in the first couple of years. This forecast reflects the positive influence of improved competitiveness and the sliding dollar on exports and dampening effect of slower U.S. consumer spending on imports. Until recently, the greenback was being pulled in opposite directions. The huge current-account deficit has been pushing down its value while the combination of stronger domestic growth and higher U.S. interest rates have buoyed the dollar. But this situation has changed because the U.S. economy has begun to slow and interest rates are expected to fall. As a result, all forces are exerting downward pressure on the dollar. Under these conditions the euro is expected to rise from around $1.33 in late 2006 to $1.40 by the end of this year. Over this same period the yen will rise from $0.87 to $0.95 and the Chinese renminbi will appreciate about 5%.



Housing: The housing industry should remain a short-term drag on the U.S. economy. It has been estimated residential construction shaved 1.4 percentage points off GDP growth in the fourth quarter of 2006 and will shave another 0.9 percentage point off output in 2007. Other indicators confirm this sector's weakness. Housing starts plunged 14.6% in October 2006 and the number of housing permits dropped 6.3% for its ninth straight month. Despite the spate of bad news, there are several factors that suggest housing demand is near its bottom. First, inventories of new and existing homes appear to be stabilizing. Second, sales of existing single-family homes seem stable. Third, applications to purchase homes have risen. These conditions are largely due to both falling mortgage interest rates and home prices. From June 2006 to last fall the 30-year fixed mortgage rate tracked by the Mortgage Bankers Association fell just over 80 basis points. In addition, the National Association of realtors reported the median price of an existing home dropped 3.4% between October 2005 and October 2006. Although there are reasons to believe demand is stabilizing, a housing turnaround is not imminent. The current



housing inventory needs to be whittled down before starts and spending recover. With housing prices adjusting sluggishly to weak demand, new and existing home sales should rebound in this year's second half. These sales will help the inventory of new houses to peak later this year then gradually decline. Eventually housing starts will increase again, but at the pace experienced during the first years of this decade. Specifically, U.S. housing starts hit 2.1 million units in 2005—its most recent peak. The forecasted number of starts is 1.8 million in 2006, 1.5 million in 2007, 1.6 million in 2008, 1.7 million in 2009, and 1.8 million in 2010.